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**Paper title:**

Change in tobacco excise policy in Bulgaria: the role of tobacco industry lobbying and smuggling

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**Author Contributions:**

VS: Contributed to the initial document searching to scope the project, conducted the document searching and analysis, obtained and reviewed background literature, drafted and edited the report.

KES: Analysed the interview data and contributed to editing of the report.

BR: Helped prepare the interview schedule, developed questions for the interviewees, helped with the translation of the participant information and consent form, undertook the interviews, obtained background literature and contributed to editing of the report.

AG: Conceived the idea for and directed the overall project including this case study, supervised the document and interview analyses, helped prepare the interview schedule, drafted sections of and edited the report.

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## **ABSTRACT**

**Objectives:** To examine how Transnational Tobacco Companies (TTCs) tried to penetrate the Bulgarian cigarette market and influence tobacco excise tax policy after the fall of communism and during Bulgaria's accession to the EU.

**Design:** Analysis of internal tobacco industry documents supplemented by analysis of press coverage, tobacco industry journals, market reports, and key informant interviews.

**Results:** TTCs have been involved in cigarette smuggling to and through Bulgaria since at least 1975 and used smuggling as a market-entry strategy. National tobacco company Bulgartabac appears to have been involved in smuggling its own cigarettes from and reimporting them to Bulgaria. Since Bulgaria's accession to the EU opened the market to the TTCs, TTCs have exaggerated the scale of the illicit trade to successfully convince politicians and public health experts that tax increases lead to cigarette smuggling. Yet, sources point to TTCs' continued complicity in cigarette smuggling to and through Bulgaria between 2000 and 2010. TTCs aimed to influence the Bulgarian tobacco excise tax regime, import duties and pricing mechanism, but appear to have been less successful than in other former communist countries in part due to the co-existence of a state-owned tobacco company. Undisclosed meetings between the tobacco industry and government ministers and officials are ongoing despite Bulgaria being a party to the Framework Convention on Tobacco Control (FCTC).

**Conclusion:** The TTCs continued involvement in smuggling suggests that deals in 2004, 2007 and 2010 which the European Commission has reached with TTCs to address cigarette smuggling are inadequate. The TTCs' continued access to policymakers suggests that the FCTC is not being properly implemented.

## BACKGROUND

One of the most effective means of reducing tobacco consumption is through taxing tobacco products[1-4], which also raises government revenue[5, 6]. Tobacco taxation is also a key concern for transnational tobacco companies (TTCs) as different tax structures offer different opportunities and threats depending on the company's brand portfolio and the market in question (Table 1).

**Table 1 Characteristics of different types of tobacco excise tax structures**

Excise structure	Description	Effects on companies by context
<b>Specific</b>	<ul style="list-style-type: none"> <li>Levied as a fixed value (per cigarette weight/pieces/pack/carton)</li> </ul>	<ul style="list-style-type: none"> <li>Companies with expensive brands usually favour this structure, as it reduces the potential for price differences between expensive and cheaper cigarette brands (thereby favouring expensive cigarettes)</li> <li>For the same reasons, companies with cheaper brands usually dislike this structure.</li> </ul>
<b>Ad-valorem</b>	<ul style="list-style-type: none"> <li>Levied as a percentage of retail price</li> </ul>	<ul style="list-style-type: none"> <li>Companies with cheaper brands usually favour this structure, as it can lead to a large price discrepancy between their cheap brands and other, more expensive brands.</li> <li>Companies with expensive brands usually dislike this structure due to the price discrepancy discussed above.</li> </ul>
<b>Mixed</b>	<ul style="list-style-type: none"> <li>Incorporates both specific and ad valorem components</li> </ul>	<ul style="list-style-type: none"> <li>Companies with mid-range or with a broad portfolio of brands (i.e. expensive and cheaper products) usually prefer a mixed structure.</li> </ul>
<b>Tiered</b>	<ul style="list-style-type: none"> <li>Tobacco excise may also be <i>tiered</i>, with different tax levels applied to different categories of tobacco product (e.g. cigarettes may be categorised by length or source - whether locally produced or imported)</li> </ul>	<ul style="list-style-type: none"> <li>Companies that produce tobacco products that conform to the lower tax levels will usually favour a <i>tiered</i> structure that discriminates in favour of their products.</li> <li>Vice versa, companies whose products fall into the higher tax tiers usually dislike this structure.</li> </ul>

Source: Table adapted with permission from Shirane et al[7]

Despite the importance of tobacco tax policy to public health there is only limited research outside North America exploring how TTCs attempt to influence policy in this area, with most research examining TTC influence on tax levels rather than structures[8]. Existing research on TTC influence on tobacco control policy in post-communist countries has focused on the former Soviet Union[9-16].

This paper examines what strategies TTCs used to enter the Bulgarian market and how they tried to influence Bulgarian tobacco tax policy. The analysis focuses on the period 1988 to 2011, and covers the collapse of communism, attempts to privatise the state-owned tobacco monopoly, and Bulgaria's accession to the European Union (EU) in 2007.

## **METHODS**

The Legacy Tobacco Documents Library website (<http://legacy.library.ucsf.edu/>) was used between June 2011 and October 2011 to search internal tobacco industry documents for words initiating with Bulgar\* in their title and combinations of words such as 'excise', 'tax', 'ad valorem', 'strategy'. In total, 1620 documents were reviewed to establish relevance. Additional data from tobacco industry journals, newspapers, and market reports, were used to supplement the document analysis. Most industry documents found were from British American Tobacco (BAT) and Philip Morris International (PMI). This is partly due to the nature of the Library which only includes documents from companies subject to the litigation which led to document discovery, and also reflects that BAT and PMI were most active in penetrating the Bulgarian market.

For triangulation purposes, four semi-structured interviews were conducted in Bulgarian by a bi-lingual native-speaker with key informants knowledgeable of tobacco industry and

taxation developments in Bulgaria. Finding tobacco control experts working in government proved very difficult. Two interviewees were former civil servants. A third interviewee still working in government did not provide any information cited in this report. A further four civil servants in different Ministries declined or failed to respond after initial contact. Representatives of the tobacco industry (BAT, PMI and Bulgartabac) failed to respond or refused to participate in the research. Interviews were carried out following approval by the Research Ethics Committee at the University of Bath's Department for Health.

## **RESULTS**

The Bulgarian tobacco industry was nationalized in 1951. Although the tobacco market gradually opened to foreign competition from 1989 onwards, successive governments made several failed attempts to privatize the industry since 1998[17], and the national tobacco company, Bulgartabac, remained state-owned until October 2011[18](Box 1). This is of particular interest for excise tax policy since state monopolies generally produce cheaper brands than TTCs and tend to protect their local brands via ad valorem taxation (Table 1).

### **Box 1 Privatisation history of Bulgarian national tobacco company Bulgartabac**

#### **First Attempt: April 1998 – March 2001**

- Context: Privatisation Agency established. Stringent conditions applied to sale (no one party allowed to buy majority stake). IMF supported privatisation process, expressing confidence “that the company can be brought to the point of sale by end-1999”[19].
- Result: PMI, Gallaher and Reemtsma submitted letter of intent to bid, but in July 2000, the tender was terminated and new bids were invited. Privatisation procedure terminated for second time in March 2001 without selecting a buyer.

#### **Second Attempt: Spring 2002 – April 2003**

- Context: Newly elected coalition government eager to complete privatisation. On offer was an 80% stake in Bulgartabac Holding. Conditions of sale required that no Bulgartabac staff would be made redundant.
- Result: Deutsche-Bank owned Tobacco Capital Partners made winning bid of 110 million euro. The Higher Administration Court rejected deal on basis of conflict of interest, as owners of Tobacco Capital Partners were solicitors who had participated in legal analysis of Bulgartabac. In April 2003 the government rejected deal considering it unfavourable.

#### **Third Attempt: June 2003 – February 2005**

- Context: Piecemeal sale of Bulgartabac announced, with 9 cigarette production companies and 12 processing subsidiaries on offer.
- Result: BAT offered 200 million euro to buy three best performing cigarette factories, but following opposition from Turkish ethnic minority party (MRF) in coalition government, BAT withdrew its offer in February 2005. IMF said privatization delays “remained troubling”, and welcomed plans to privatise Bulgartabac Holding by 2004[20].

#### **Fourth Attempt: February 2005 – October 2011**

- Context: In light of falling Bulgartabac revenues, Bulgartabac sought to improve its market share before following privatisation round. In 2009, two less profitable plants were sold on Stock Exchange.
- Result: BAT appeared interested, but withdrew from tender in April 2011. In October 2011 Austria-registered BT Invest, the only remaining contender, bought a 79.83% stake in company for 100.1 million euro. One press report speculated that MRF was linked to the undisclosed buyer of Bulgartabac[18].

BAT and PMI documents indicate that these two companies have been interested in the Bulgarian market at least since 1975[21, 22], and have been at the forefront of TTC activity in Bulgaria since the collapse of the communist regime (1989). Reasons for their interest are outlined in Box 2. BAT appeared primarily interested in establishing local production in the 1990s (Box 1)[17, 23-27], while PMI was, and remains, primarily interested in gaining market share via imports[28-30].



## Box 2 Why TTCs viewed Bulgaria as lucrative market

### **Reason 1: Exploiting existing production infrastructure**

- Low average salaries and high production of tobacco leaf and products[31]
- Increased profits possible by reducing workforce employed in tobacco industry[31]
- Possibility of reducing amount of tobacco in each cigarette via updated leaf treatment techniques, thus further improving productivity and profit margins[31]

### **Reason 2: Expansion of existing tobacco export business**

- Exploiting Bulgaria's geographical location and cigarette output which would enable "transit trade"[22, 32], including export opportunities into closed markets of USSR, Eastern Europe, as well as Turkey where major local tobacco company was government owned until 2008[22, 28, 31]
- Bulgaria's cigarette production portfolio was (in late 80s) good for Africa and Middle East, where market for low-price brands was growing[31]

### **Reason 3: Expansion of existing brand portfolio**

- Prospect for joint-venture with Bugartabac to produce foreign brands in Bulgaria[31]
- Bulgarian tobacco industry could be highly competitive in low-price segment[28]
- Potential for developing premium products, and low nicotine cigarettes destined for export to USSR[31]

## **Cigarette imports and the illicit tobacco trade**

Prior to market liberalisation, western consumer goods could only be purchased in shops selling Western products in exchange for hard currency. Foreign cigarettes, inaccessible to most locals, became highly desirable; something which the TTCs were keen to exploit[33]. PMI's strategy in the early 1990s was to "lobby government officials directly [...] on the benefits of the hard currency outlets until such time as consumers may freely purchase the same goods on the domestic markets"[28]. Although cigarette imports were allowed in Bulgaria from 1989, the government used a variety of tariff and non-tariff barriers to protect local production of tobacco[34](see Table 3). Consequently, imports destined for duty-free sale were also used to facilitate cigarette smuggling into Bulgaria[35]. In 1996, the then Bulgarian deputy Finance Minister, Bisser Slavkov, expressed concern that cigarettes

imported for duty free sale “simply disappear”, stating that of 2000 tons of imported cigarettes only 150 tons had customs declarations[36].

Tobacco industry documents suggest that TTCs were involved in cigarette smuggling to and through Bulgaria at least since 1975[21, 22], and remained involved for decades[21, 22, 32, 33, 37]. Documents refer to “transit” trade[22, 32], “general trade”[37], and “duty not paid” cigarettes[38] in Bulgaria; all known industry euphemisms for smuggling[39-41]. A PMI document from 1975 speaks of cigarette imports for both the duty-free and the domestic market, when imported cigarettes could only be legally sold via duty-free or hard currency shops[22]. This document mentions “transit” business from Bulgaria to Italy and Turkey[22], both of which were closed markets with state-owned tobacco monopolies at the time[42], and discusses company plans to “follow up closely development of transit in order to continue increasing [PMI] market share”[21]. A BAT document from 1992 reflecting on illicit trade in Bulgaria states that:

*“Due to the high duties on imported cigarettes and spirits there is nothing such as totally legal imports, most importers use the duty-free facade to import goods and get around paying full duties”[32].*

In 1994, BAT estimated that 99% of all imported cigarettes (both BAT and other brands) were imported via “general trade”[37] and identified the “continuation of parallel trade” in Bulgaria as an opportunity for BAT, while the “enforcement of banderoles” (which indicates if tobacco excise duties have been paid) was listed as a potential threat to BAT’s business[37]. A more recent company plan for 2000-2002 states that “stricter governmental restrictions and comprehensive market and trade controls” were an obstacle for BAT’s business in Bulgaria[43].

In 2000, a civil action was filed by the European Community in New York against PMI and RJ Reynolds (by 2000 Japan Tobacco Inc. had acquired the non-US operations of RJ Reynolds to become Japan Tobacco International), accusing them of involvement in tobacco smuggling[44, 45]. Legal settlements were reached with PMI in 2004[46, 47], with Japan Tobacco International (JTI) in 2007[48] and with Imperial Tobacco and BAT in 2010[45, 49, 50]. Sources suggest that, following the settlements, TTC involvement in large-scale smuggling fell from 2000, although new forms of illicit trade emerged[45, 51, 52]. These sources looked at discrepancies between cigarette imports and exports, using government figures (USA, UK, Spain, Italy)[45, 51, 52] which are not always accurate or reliable[52]. The Legacy document archive primarily covers documents up to 2000, and we could not find internal industry documents to determine whether TTCs have continued to smuggle cigarettes after 2000. Yet, a lawsuit won by Gallaher (in 2007 Japan Tobacco International acquired the Gallaher Group) against a Cyprus based distributor in 2008, revealed that Gallaher was complicit in smuggling its own cigarettes between 2000 and 2004 through Bulgaria[53]. A report by the Organized Crime and Corruption Reporting Project claims that JTI internal investigators found JTI to be complicit in smuggling its own cigarettes to and through EU member states in 2009 and 2010, via routes including ‘the Balkans’, but it is unclear whether this included Bulgaria[54]. JTI investigators behind these allegations have since been sacked by JTI management[54].

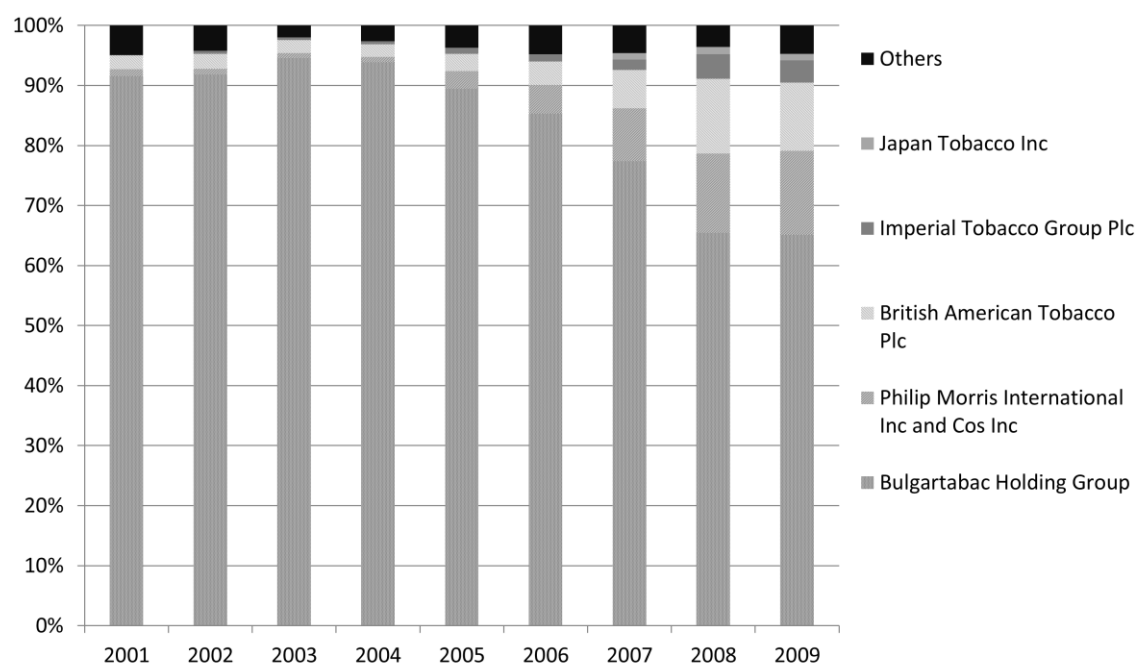
In addition to TTC involvement, tobacco industry journals (likely to favour a TTC viewpoint) suggest that Bulgartabac may have also been involved in smuggling its own cigarettes for sale both within and outside Bulgaria[55]. One interviewee suggested that politicians may also be involved in facilitating illicit trade (Interviewee 4, NGO representative). Research by the Centre for the Study of Democracy (Bulgaria)[35] indicates that in 2003, when

Bulgartabac was the only national cigarette manufacturer, cigarettes manufactured in Bulgaria were fictitiously exported from and re-imported to the country, thus avoiding excise duties and VAT[35]. A United Nations report on the illicit trade of tobacco and other drugs also states that in 2007, cigarettes produced in Bulgaria and Luxemburg were illicitly imported to Libya[56].

### Change of TCC approach to the illicit trade after EU accession

Bulgaria's accession to the EU required the abolition of administrative price-setting (removed in July 2006)[57], the lifting of import duties (in January 2007)[57], and the implementation of EU tobacco tax directives (see next section). These changes led to an increase in the official market share held by the TTCs (Figure 1).

**Figure 1 TTC market share of cigarette sales in Bulgaria 2001- 2009 (%)**



Source: Adapted from Euromonitor (2010) Cigarettes - Bulgaria[62]. Represents legal sales only.

While illicit trade featured heavily in the TTCs' documents but not in their public discourse prior to accession, after accession TTCs now regularly publicise their own research on

smuggling and use smuggling as an argument against increasing tobacco excise tax rates[45, 58, 59]. For example, in 2007 a representative of the National Union of Tobacco Producers warned that the planned excise tax increases would raise smuggling by around 20% resulting in large financial losses for the treasury, without indicating how this estimate was produced[58]. In 2009, the general managers of leading TTCs advised Bulgarian government officials that long-term stability of cigarette excise tax rates was necessary to curb the rise in smuggling[60], and in January 2010, a Bulgartabac spokesman warned that as a result of excise tax increases, illicit trade would be expected to make up 40% of Bulgarian cigarette sales that year[61]. This estimate was based on a survey of unknown methodology conducted by Bulgartabac[61]. In 2011, PMI released research which estimated that illicit trade had reached 34% of total sales in 2010[59], similar to the 30.7% figure for 2010 recorded in a KPMG report on cigarette smuggling commissioned by PMI as part of its 2004 agreement with the European Union[45]. KPMG report estimates are based on a variety of data but with heavy reliance on data and expertise from industry, while illicit trade estimates are based on cigarette seizures which exclude smuggled cigarettes which pass unnoticed[45].

A comparison of the figures the industry uses on the illicit trade with a variety of independent sources, suggests that the industry significantly overstates the extent of the impact that tax increases will have on the illicit trade. Euromonitor data (apparently based on official statistics, industry data, and Euromonitor's own estimates) indicated that the proportion of illegal sales increased from 6% to 27% between 2004 and 2009[62], falling to 24% in 2010[63] (see Table 2). Eurobarometer estimates, based on survey data from face-to-face interviews with 1000 individuals from a stratified random sample, are lower, suggesting that 21% of Bulgarians thought they had bought smuggled cigarettes over a 6 month period in 2008[64]. According to other independent survey data, also based on a stratified random

sample and face-to-face interviews with 1027 respondents, in 2010, 14.5% of Bulgarians reported that their latest cigarette pack was smuggled[65]. The fact that independent interview-based estimates of illicit trade are considerably lower than industry estimates could be explained by differences in methodologies, by interviewees underreporting smuggling, by the industry over-reporting smuggling, or a combination of the above.

**Table 2 Trend in illicit cigarette sales in Bulgaria (million sticks)**

	2004	2005	2006	2007	2008	2009	2010
<b>Legal sales</b>	21,455.2	21,208.1	20,814.4	20,065.7	18,773.7	16,457.2	16,691.7
<b>Illicit trade</b>	1,278.3	1,696.6	2,497.7	2,976.3	3,922.2	5,979.1	5,276.9
<b>% penetration of illicit trade</b>	5.7	7.4	10.7	12.9	17.3 <sup>1</sup>	26.6 <sup>1</sup>	24.0 <sup>1</sup>
<b>Actual consumption</b>	22,742.5	22,904.7	23,312.2	23,042.0	22,695.9	22,436.3	21,968.6

Source: adapted from Euromonitor (2010) Cigarettes – Bulgaria, and Euromonitor (2011) Tobacco in Bulgaria  
Note 1: 2012 the Euromonitor website released revised illicit trade estimates for years 2008 (at 13.8%), 2009 (at 17.5%) and 2010 (at 39.7%) [Euromonitor International, "Illicit Trade Volumes". Global Market Information Database, Chicago, IL. 2012]. The revised estimates have not yet been published in a Euromonitor report.

Yet, TTC arguments appear to have influenced Bulgarian press and politicians, despite well-established evidence that large scale smuggling is linked to TTC involvement rather than cigarette prices[66, 67]. A brief search of Bulgarian press reports indicates that TTC arguments regarding smuggling are rarely questioned and the press relies heavily on citing industry figures on smuggling[59, 61, 68-71]. One of our interviewees pointed out that in 2010, PMI research on cigarette smuggling was widely publicised:

*“...they waved it around in the Parliament and in the media to the left and to the right...It caused a scandal in the Parliament: some people accept it, others do not”*

(Interviewee 2, senior public health professional).

In December that year, Bulgaria’s former Minister of Interior openly criticised the government over increases in cigarette excise tax, arguing that they had caused a rise in smuggling[72]. The following January (2011), the chief of the Customs Agency urged

Parliament to allow Bulgartabac to release new cheap cigarette brands “for the poor” in view of unaffordable prices and reportedly high levels of smuggling[73]. An NGO employee interviewed for this research seemed convinced that price increases lead to a rise in smuggling. A physician and associate professor specialised in public health, spoke of the presumed link between price hikes and smuggling:

*“Currently, the political debate between the governing party and the opposition party is about the sharp increase in excise which has led to greater cigarette smuggling. It is reported that smuggling has increased by more than one third.”* (Interviewee 2, senior public health professional)

The latter interviewee remained uncritical of potential TTC interests in portraying a high level of smuggling: *“Philip Morris have an interest in entering the official sector because they are a company after all, which is interested in this, and not [interested] in the contraband”*(Interviewee 2, senior public health professional). This view persists despite well documented evidence of TTC complicity in cigarette smuggling[35, 39, 40, 44, 74, 75].

### **Industry lobbying to change excise tax structures and levels**

TTCs have actively lobbied the Bulgarian government, since 1989, to change import duties[43, 76-78], excise tax structures[28, 71, 76, 77, 79], and subsequently excise tax levels[79]. A PMI business plan for 1990-1992 suggests that “Influenc[ing] the taxation regime to achieve favourable conditions for excise tax and import duties”[78] was seen as a key strategy for improving company profitability in Eastern European markets such as Bulgaria. Similarly, BAT, as early as 1994, identified price setting and the existing excise tax system as “decisive investment ‘obstacles’ ” which they hoped to influence[80].

### *TTC excise tax structure preferences*

BAT and PMI hoped to change Bulgaria's fully ad valorem excise tax structure to one more favourable to their products[28, 71, 76, 77, 79]. BAT favoured a mixed system with a high specific component[76] which would presumably help benefit its broad brand portfolio over both PMI's more concentrated focus on premium brands and Bulgartabac's cheap, local brands[7]. During a meeting between BAT, Bulgartabac board-members and Bulgarian government officials in 1991[76], BAT presented a general overview of taxation systems to Bulgartabac representatives explaining that the same total cigarette excise tax yield obtained in 1991 from a wholly ad valorem excise tax structure could be derived from a mixed structure, thus maintaining government revenue[76].

PMI, by contrast, pushed for a fully specific excise tax structure in the 1990s in most Eastern European markets[28] including Bulgaria[30]. A specific system would narrow the price differential between PMI premium imported brands, particularly Marlboro, and cheaper local brands as well as other imported brands from competing TTCs[7]. In 1994, the fully ad valorem system was switched to a fully specific taxation system for 2 years (Table 3). However, this was a limited success for PMI as the system was tiered with imported cigarettes taxed more[81]. Fifteen years later, in 2009, PMI appeared to pursue similar excise tax changes with PMI Director of Corporate Affairs for Bulgaria and Romania, Peter Imre, urging the Bulgarian Deputy Finance Minister to implement a minimum excise duty to guarantee tax revenues for the government and reduce the price differentials between cheap and expensive cigarettes[71]. It is difficult to establish to what extent TTC lobbying affected excise tax structures but the changes introduced in 2010 benefitted premium brands (Table 3).



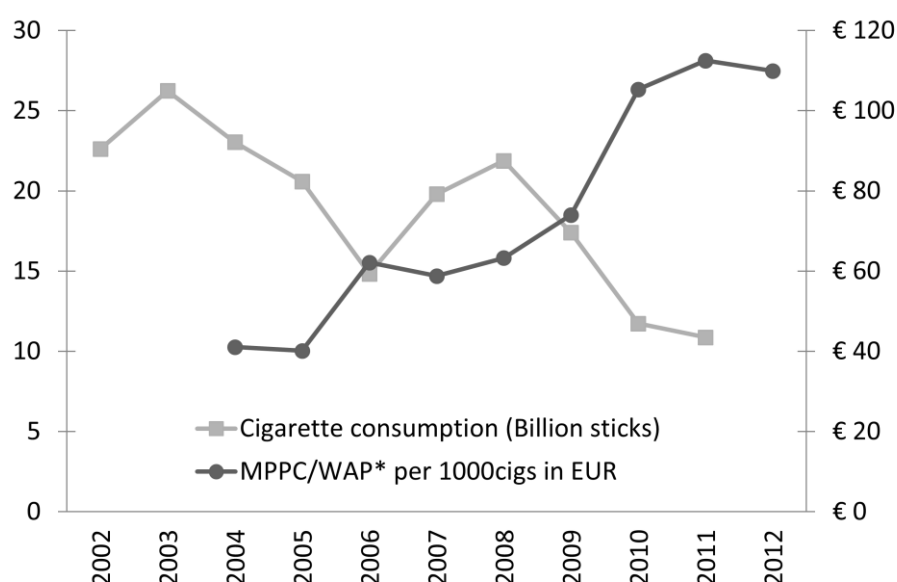
**Table 3 Overview of changes to tobacco excise tax structures in Bulgaria 1988-2011**

Year	Ad valorem (% of TIRSP <sup>1</sup> )	Specific (BGL/BGN <sup>2</sup> per 1000)	VAT (%TIRSP <sup>1</sup> )	Import Duty (% of Customs value)	Import tariff surcharge <sup>3</sup>
1988	70-80%	0	n/a <sup>1</sup>	n/a	0
1989	<i>Excise tax reduced (levels unknown)</i>	0	n/a	n/a	0
1990	Filter cig (boxed) 22% Filter cig (soft pack) 19% Plain Cig 15%	0	n/a	n/a	0
1991	60%	0	n/a	n/a	15%
1992	60%	0	n/a	80%	15%
1993	60%	0	0	40%	3%
1994	0	Luxury cig: BGL 1000 Brand cig: BGL 600 Ordinary cig: BGL 300 Cigs. w/out filter: BGL 100 Cigars & cigarillos: BGL 400	18%	40%	2%
1995	0	Luxury cig: BGL 1600 Brand cig: BGL 900 Ordinary cig: BGL 450 Cigs. w/out filter: BGL 100	18%	40%	1%
1996	60% (from 1/July)	Priced up to BGL 60 at BGL 3000 Priced over BGL 60 at BGN 10000 (until 30/June)	18%	40%(min 10 USD/1000)	Tax lifted
1997	60%	0	n/a	40%(min 7.7 ECU <sup>2</sup> /1000)	
1998	(New mixed sys) 30%	BGN 2	22%	40%	
1999	30%	BGN 2	20%	68%	
2000	Filter: 30% Non-filter: 10%	BGN 2	20%	50%	
2001	Filter: 30% Non-filter: 10%	Filter: BGN 2 Non-filter: BGN 1	20%	50%(min 9.6 EUR/1000)	
2002	Filter: 40% Non-filter: 15%	Filter: BGN 2 Non-filter: BGN 1	20%	50%(min 9.6 EUR/1000)	
2003	Filter: 40% Non-filter: 15%	Filter: BGN 2 Non-filter: BGN 1	20%	200%(min 36 EUR/1000)	
2004	Filter: 43.5% Non-filter: 20%	Filter: BGN 4 Non-filter: BGN 2	20%	200%(min 36 EUR/1000)	
2005	Filter: 43.5% from Feb (31.8% in Jan) Non-filter: 20%	Filter: BGN 4 Non-filter: BGN 2	20%	200%(min 36 EUR/1000)	
2006	All types: 48%	All types: BGN 15	20%	200%(min 36 EUR/1000)	
2007	54%	BGN 6.5	n/a	27.95% <sup>4</sup>	
2008	35%	BGN 37	n/a	27.95% <sup>4</sup>	
2009	40.5%	BGN 41	n/a	27.95% <sup>4</sup>	
2010	23%	BGN 101	16.67%	27.95% <sup>4</sup>	
2011	23%	BGN 101	16.67%	27.95% <sup>4</sup>	
2012	23%	BGN 101	16.67%	27.95% <sup>4</sup>	

Source: The Bulgarian National Customs Agency provided data on import duties, and ad valorem and specific excise tax for 1993-1997, 2001-2006. Further figures obtained from EU Commission excise tables, industry documents, news reports. N/A = not available. Note 1: TIRSP (Tax Inclusive Retail Sales Price) is a term introduced by the EU, but ad valorem taxation in Bulgaria was calculated on tax inclusive retail sales price from at least since 1988. Note 2: Old Bulgarian Lev (BGL) replaced with New Bulgarian Lev (BGN) on 1st July 1997. BGL 1000 = BGN 1, BGN 1 = EUR 0.51(www. xe.com 06/Jul/12). ECU (European Currency Unit) ECU 1 = BGN 1.93 rate on 1st December 1997. Note 3: Import tariff surcharge introduced for 1991-1995[32, 34], calculated on amount due for import duty. Note 4: Intra-EU duties lifted in 2007, import rates from 2007 onwards therefore apply only to non-EU imports.

The frequent excise changes appear to have influenced cigarette prices and consumption, although we only have access to complete data for 2004-2011(Figure 2), and due to occasional large scale releases of cigarettes for consumption prior to tax increases, consumption figures for some years may be artificially high[82]. A notable rise in price in 2006 reflects the rise in both ad valorem and specific duties that year, and a similar spike occurred in 2010 when specific excise more than doubled. Legal sales fell on both occasions.

**Figure 2 Cigarette consumption and Cigarette prices in Bulgaria 2002 – 2012**



Source: EU Commission Excise Duty Tables (for 2002 – 2012). \*WAP applies for year 2011-2012 only

### *External pressures on excise tax policy as opportunities for TTCs*

During integration into the European and international markets, Bulgaria faced pressures to facilitate trade. Accession to the World Trade Organisation (WTO) prohibited preferential treatment of local manufacture, e.g. via discriminatory taxes[83]. Similarly, EU accession required Bulgaria to abolish import duties for imports within the EU and administrative price setting[57], and implement EU tobacco tax directives. The latter required a mixed excise tax system and an overall minimum excise duty (specific duty plus ad valorem duty excluding

VAT) of 57% of the retail selling price (inclusive of all taxes) for cigarettes of the most popular price category (MPPC)[84, 85]. Further amendments to the directive (99/81/EC and 2002/10/EC) added that the minimum total excise tax would be 60 Euros/1000 cigarettes (64 Euros/1000 from 1 July 2006)[86].

TTCs hoped to capitalise on such pressures from accession to the WTO in 1996,[87] and EU accession in 2007, in order to avoid “discriminative taxes” against imported products[76, 77]. On April 10<sup>th</sup> 1996, during one of several meetings held between Mr Schlunk, “a qualified BAT-Germany expert in the field of duties and excise taxes”[77] and Mr Mladenov, chairman of the supervisory board of Bulgartabac and member of the Bulgarian Ministry of Trade[77], Schlunk noted that, in line with WTO principles, “differentiation between domestic and international brands is not acceptable”. Schlunk advised that, “as an option acceptable for WTO” a three-tier taxation structure could be adopted where imported cigarettes and expensive Bulgartabac brands could both be taxed at the same level[77]. Two weeks later, the Ministry of Trade announced it was “working on a new method for calculation of tobacco products excise tax” which would be “based on a firm price and a percentage of the price of cigarettes”[77](i.e. a mixed system). The Minister indicated that the change was being introduced to avoid discriminating against imported cigarettes[77]. This, and BAT’s note about the announcement, suggests that the change in policy may have been influenced by BAT:

*“The statement of Mr Paparizov [Minister of Trade] was done only a few days after the meeting of Mr Schlunk from BAT Germany and Mr Rossen Natchev from B.A.T Bulgaria with experts from the Trade Ministry. This statement is fully in compliance with the advises given during the above meeting and can be considered as a direct result of it”[77].*

We were unable to confirm this fully through excise tax data (Table 3) and although subsequent excise tax changes tended to benefit BAT, they were not exactly what BAT had requested. A two tier system that would have benefitted BAT over Bulgartabac and could have been the result of its lobbying was introduced at some time in 1996 to replace the four-tiered system, but it is unclear whether this followed the April 1996 meeting. The government then reverted back to a fully ad valorem system in 1996-97, and a mixed excise tax system was only introduced in 1998 (Table 3).

The Bulgarian government's desire to adhere to EU and WTO demands, to protect Bulgartabac profits, and simultaneously deal with industry lobbying on tobacco excise tax, led to frequent changes in policy (Table 3). For example, price-setting was removed briefly in January 2005[17, 88] but, when Bulgartabac brands suffered, Bulgartabac petitioned the Ministry of Finance and the mechanism was restored three months later[17] only finally being abolished in 2007[88] as a requirement for accession. Similarly on import duties, following a 1999 memorandum between the Bulgarian government and the EU, import duties on filter cigarettes imported from EU countries were to be capped at 52% applicable from 2001[43, 89]. In order to compensate for the fact that imported cigarettes would become cheaper and reduce the price gap between local and imported brands[90], the government temporarily raised import duties from 40% in 1998 to 68% in 1999 to protect Bulgartabac[90], and subsequently reduced them to 50% in 2000(Table 3). This prompted TTC lobbying to reduce the duty downwards[43]. The government then introduced a "hidden increase in import duty"[43] in the form of a 5% of Duty Paid Landed Cost[43] which BAT set out to revoke[43], and in the three years prior to accession raised import duties to an all-time high of 200% (Table 3). Intra-EU import duties were lifted with Bulgaria's accession in 2007.

### *The process of industry influence*

To influence Bulgarian policy, industry documents reveal that BAT had repeated, direct contact with Bulgartabac representatives[23, 24, 31, 32, 76, 77, 80, 90, 91] and other government officials[90, 92]. In 1998 BAT claimed to have “immediately established contacts with the Ministries of Trade and Finance as well as with the National Assembly and are arranging meetings at highest levels”[90]. A tobacco control expert formerly working for the Bulgarian Ministry of Health explained how TTCs tried to influence Bulgarian government decisions on EU accession changes, describing the contacts of PMI and BAT with the Ministry of Health as “*very aggressive...in all respects, very aggressive with proposals*”(Interviewee 1, former Ministry of Health employee). The interviewee recounts that:

*“Before we received the official minutes [of Ministry committee discussing EU accession decisions], even before we even had any of the documents, they [TTCs] were already telling us what their opinion was and what should happen, and that when we’re voting we should take this, that and the other into account, when we’re at various meetings... They often asked me, ‘Who’s going to be at that meeting?’ so they could contact them directly.”* (Interviewee 1, former Ministry of Health employee)

TTCs have continued to lobby Bulgarian ministers and high-level politicians directly in recent years. In 2009, PMI representatives discussed Bulgaria’s excise tax system with the Deputy Finance Minister[71]. Representatives from major TTCs and Bulgartabac met with Bulgarian Deputy Prime Minister and Minister of Interior in 2010[60] and with the Prime Minister, the Finance Minister, the head of the Customs Agency, and the head of the Criminal Police Directorate in 2011[93] to discuss the government’s crack-down on illicit trade.

## **DISCUSSION**

### **Smuggling**

Prior to EU accession TTCs actively participated in the illegal import of their cigarettes into Bulgaria, and through Bulgaria to other closed markets. This finding supports existing evidence of the TTCs' widespread use of smuggling as a market access strategy[7, 11, 13, 94, 95 ]. Also, the duty-free business was used as a disguise for illicit trade in Bulgaria[32], as has been done elsewhere[39, 96-99], highlighting the need for duty-free sales to be ended. There is evidence that TTC involvement in cigarette smuggling continued post-2000 and up until 2010, despite the 2000 legal case[44]and subsequent settlements[45-50]. Corruption and possible political involvement in smuggling are underlying concerns and Bulgartabac may also be involved[35, 55, 56]. This is consistent with evidence from Montenegro of high-level political involvement in cigarette smuggling[100, 101] and of the complex links between cigarette smuggling, corruption and organised crime[102-105].

Finally, while previously silent on smuggling, after EU accession TTCs now propound the idea that stability of cigarette excise tax rates is key to preventing smuggling to Bulgaria[60, 71, 93], having also used this argument elsewhere[66, 67, 106]. Such claims contrast with historical and well established research on EU countries which suggests that large-scale cigarette smuggling is unrelated to price, generally being higher where cigarettes are cheaper[66, 67, 106] and with more recent research based on interviews with smokers which indicates that levels of illicit tobacco use in Europe are unrelated to price[107]. Nevertheless, our interview data suggest that the price argument is widely believed in the Bulgarian public health community. Comparisons between industry data and independent data on smuggling also suggest that, as in Poland[108], the industry may exaggerate the extent of the illicit trade.

There is a need to use independent data on the extent of the problem, rather than relying on industry commissioned research[45](See Box 3).

### **Tobacco Excise Tax Policy and Bulgarian EU accession**

This paper shows that influencing the excise tax regime, import duties and pricing mechanism was a central part of BAT's and PMI's business strategy for Bulgaria[43, 77, 78]. Also, demands from WTO and EU accession, provided TTCs with opportunities to influence policy in their favour, as discussed elsewhere[86]. Ultimately, Bulgarian excise tax policy reflected a complex balance between government efforts to protect Bulgartabac, TTC influence, and the need to meet EU and WTO requirements, which resulted in frequent and abrupt changes in excise tax structures and levels. Comparing cigarette prices and consumption from 2004 onwards suggests that large increases in excise were largely reflected in price increases and decreases in legal cigarette sales.

As in other countries[2, 7, 15, 109], BAT and PMI lobbied for different excise tax structures in Bulgaria[76]. BAT pushed for a mixed excise tax system and claimed it had influenced excise tax changes in May 1996[77]. Yet, in 1994 and 1995 a fully specific (tiered) system was introduced, which PMI lobbied for in the 90's[28, 30] . A sudden switch to a specific system was also observed in Poland in 1993[110] following successful PMI lobbying, and in the Czech Republic in 1991 possibly as result of PMI lobbying[7]. PMI may have influenced this policy change in Bulgaria although we were unable to obtain direct evidence to this effect. In 2009 PMI lobbied for minimum excise tax in Bulgaria[71] while in other European countries (Austria, France, Italy, Belgium), PMI is thought to have successfully lobbied for minimum prices (rather than duties), which were subsequently deemed illegal by the European Court of Justice under existing EU Treaties[8].

TTCs enjoyed limited influence on Bulgarian tobacco excise tax policy prior to and during Bulgaria's EU accession but were less successful in influencing import duties, administrative price setting and the excise tax system which they lobbied on since 1989[78]. Overall they appear less influential than in other former communist countries including the Czech Republic, Hungary and Poland which also joined the EU[2, 7, 14, 15]. Reasons for this may include that, a) unlike other countries explored[7, 9, 12, 13, 110, 111], the state-owned tobacco company had not yet been privatised and the government remained committed to protect Bulgartabac profits, b) the ethnic minority party MRF, a partner in coalition governments since 1992[112], was opposed to privatisation[113, 114] and may have opposed policies it deemed favourable to the TTCs, c) documentary and interview data has been more limited for Bulgaria than for other case studies conducted[7, 110, 115] and TTCs may have enjoyed greater influence than we have been able to detect.

### **Method of influence and FCTC Article 5.3**

The Framework Convention on Tobacco Control (FCTC) called for the implementation of Article 5.3, established to protect public health “from commercial and other vested interests of the tobacco industry”[116], which Bulgaria ratified in 2005. Yet, TTCs continue to enjoy access to ministers and high level politicians, which contravenes Article 5.3, with examples of this in 2009[71], in 2010[60], and 2011[93]. While some contact between government and industry may be warranted, implementation guidelines for Article 5.3 stress that government should limit interactions and ensure their transparency[117]. However, press coverage, industry documents and informant interviews suggest that current interactions do not fit these criteria and that TTCs use meetings with government officials and politicians to influence tax policy to benefit their brands. This underlines the important role for civil society groups in



exposing the nature of such meetings and holding their governments accountable for the implementation of this Article[116](Box 3) .

### **Box 3 Policy recommendations**

#### *Smuggling*

- Implement continuous independent monitoring of potential industry involvement in illicit trade.
- Consider further legal action against the TTCs and Bulgartabac on smuggling issue.
- Commission independent data on extent and nature of illicit trade is required.
- Educate public health experts, politicians and civil servants about TTCs involvement in cigarette smuggling and about the true nature of the illicit tobacco trade.
- Public health groups need to engage with media to ensure accurate coverage of smuggling issue and to ensure that industry versions of events are counterbalanced with more accurate information.

#### *Policy influence*

- Provide independent advice to politicians, civil servants and public health groups on effective tobacco excise tax policy and on industry efforts to mislead and undermine policy
- Provide future EU accession states with independent advice on tobacco excise tax policy.
- Improve implementation of FCTC Article 5.3 and monitor and expose industry (including TTC and Bulgartabac) actions.

### **What this paper adds**

To date, there is no published research looking at transnational tobacco company (TTC) strategies used to penetrate the Bulgarian market. Bulgaria is unique as it maintained a state-owned tobacco company until October 2011. Government excise tax policy had to balance government interests in the monopoly, TTC pressures to penetrate the market, and pressures resulting from Bulgaria's EU accession.

This paper shows how TTCs relied on cigarette smuggling as a market entry strategy in Bulgaria, and points to continued TTC complicity in the illicit trade between 2000 and 2010. After gaining market share, TTCs now publicise commissioned research, which exaggerates the scale of illicit trade, to erroneously convince Bulgarian politicians and public health experts that tax increases lead to increased cigarette smuggling.

TTCs tried to influence Bulgarian tobacco excise tax policy to favour their brands, but appear to have been relatively less successful than in other former communist countries due to the continued presence of the state-owned tobacco company. TTCs have continued to lobby via direct contact with ministers and officials despite Bulgaria's ratification of the FCTC in 2005.

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